

MULTIMEDIA



UNIVERSITY

STUDENT IDENTIFICATION NO

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MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 2, 2018/2019

BAC3624 – ADVANCED AUDITING

(All sections / Groups)

12 MARCH 2019
9.00 a.m – 12.00 p.m
(3 Hours)

INSTRUCTIONS TO STUDENTS

1. This Question paper consists of 10 pages excluding cover page with 5 Questions only.
2. Attempt all **FIVE** questions. All questions carry equal marks and the distribution of the marks for each question is given.
3. Please write all your answers in the Answer Booklet provided.

QUESTION 1

- (a) During the course of the audit of Greenway Sdn. Bhd. (Greenway) for the year ended 30 November 2018, you discovered that on 25 January 2019, a liquidator was appointed at Northwood Sdn. Bhd., a major customer to Greenway. The balance due from Northwood Sdn. Bhd. as of 30 November 2018 was RM800,000.

State the actions that you should take with respect to event subsequent to the reporting period date

(4 marks)

- (b) Your audit firm has been auditing Sinaran Sdn. Bhd. (Sinaran) for the past ten (10) years and you have joined the audit team for the current year audit, for the year ended 30 June 2019. While undertaking the audit planning work, you noticed that the engagement letter was dated in year 2016. List the factors, that may indicate a new engagement letter is required for Sinaran.

(3 marks)

- (c) Describe the role of the ethics partner appointed in the external audit firm.

(2 marks)

- (d) The testing of journal entries is one of the procedures used by external auditors to respond to the risk of fraud.

List the characteristics of journal entries that external auditors should select for testing to identify any fraudulent activities.

(3 marks)

- (e) Explain the difference between a report issued by an independent auditor on the audited financial statements and the examination of prospective financial information

(3 marks)

Continued...

- (f) In respect of external audit engagements, what are the key purposes of obtaining written representations from management?

(2 marks)

- (g) During the planning of the audit of Morrison Sdn. Bhd., the financial controller asked to have a private interview with you. She tells you that she suspects the payroll clerk is defrauding the company, as she is regularly going on luxurious holidays, buying new cars and spending substantial amounts of money on her house renovations. You noticed that there is only one payroll clerk who manages the single monthly payroll run.

List the actions that you would take to assess whether the financial controller's suspicions are valid.

(3 marks)

(Total: 20 marks)

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QUESTION 2

Your firm is the external auditor of Uxbridge Sdn. Bhd. (Uxbridge) for the year ending 30 June 2018. Uxbridge manufactures air ventilation systems and provides installation services to customers in peninsular Malaysia. Maream Abdullah has acted as the audit manager for the last three years and while planning for the audit, she was ill. You have been assigned to replace her and you have not worked for Uxbridge audit before. On reading the background information, you noticed the following:

- All work is carried out under short-term fixed-price contracts. Uxbridge's staff design the system to each customer's specification and then procure the components from suppliers mainly in Thailand and China. These suppliers invoice Uxbridge in their respective currency accordingly.
- The contract price is negotiated and agreed with the customer before commencement of any work by Uxbridge. It is the company's policy to recognise revenue once the customer confirms successful installation of the systems.
- Uxbridge maintains a computerised contract costing system. In the previous year's report to management, your firm identified that the contract costing system was unreliable. Uxbridge replaced the contract costing system in January 2018.
- All direct costs relating to each contract are recorded in the contract costing system which is integrated with the purchases and payroll systems. The finance director uses the cost records to calculate the value of work in progress for the monthly management accounts and the year-end financial statements.
- For the valuation of work in progress, the financial controller, a newly joined staff, adds a percentage to the direct costs to cover overheads. Provision is made for contract losses where appropriate.
- Historically, Uxbridge provided a two-year warranty against defects in the manufacture or installation of its ventilation systems. In July 2017, Uxbridge increased the warranty period to three years to match the warranties offered by its competitors. Uxbridge includes a provision for such warranties in its financial statements. The provision is based on the finance director's assessment of future claims.

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The audit strategy also includes the following extracts from the financial statements:

Statement of profit or loss for the year ending 30 June (extract)

	2018 (estimated) RM'000	2017 (audited) RM'000
Revenue	752,000	664,137
Cost of sales	<u>(484,000)</u>	<u>(460,007)</u>
Gross profit	<u>268,000</u>	<u>204,130</u>

Statement of financial position as at 30 June (extract)

	2018 (estimated) RM'000	2017 (audited) RM'000
Current assets		
Work in progress	91,500	59,300
Current liabilities		
Provision for warranty claims	620	664
Non-current liabilities		
Provision for warranty claims	752	664

The recent interim audit revealed the following internal control deficiencies:

- i. References were not obtained for new employees recruited for the teams responsible for the installation of the system and the accounts department.
- ii. Uxbridge does not routinely update its anti-malware software on its contract costing, purchases and payroll systems.

Continued...

On top of that, the board of Uxbridge has decided to seek tenders for the appointment of the external auditor for the year ending 30 June 2019. A number of firms have been invited including your firm. The engaging partner has sent you the following email:

"One of the former audit partners of our firm and a very good friend of mine, Mr Frank is currently a member of the audit committee of Uxbridge Sdn. Bhd.. He is very supportive and I would like Frank's advice before we submit our tender. While you are at Uxbridge, can you please arrange to meet him and seek out his views on the business's key issues so that we can include them in the formal tender"

Required:

- (a) Justify why the audit strategy has identified the following items as key areas for audit risks and, for each key area, describe the procedures that should be included in the audit plan to address those risks. You should present your answer using the following subheadings:

- Work in progress (justification and audit procedures)
- Provision for warranty claims (justification and audit procedures)

(20 marks)

- (b) For each internal control deficiency listed as (i) and (ii) in the scenario, draft points for inclusion in your firm's report to those charged with governance and management at Uxbridge. For each deficiency, you should outline the possible consequence(s) of the deficiency and provide recommendations to address it.

(6 marks)

- (c) Discuss the principal ethical issues arising in respect of the email sent by the engaging partner and state the actions that you should take.

(4 marks)

(Total: 30 marks)

Continued...

QUESTION 3

Described below are situations which have arisen at four unrelated external audit clients of your firm. The year end in each case is 31 December 2018.

Aldi Sdn. Bhd. (Aldi)

The directors of Aldi have refused to provide a letter of representation that all transactions have been recorded and reflected in the financial statements during the audit.

Morison Sdn. Bhd. (Morison)

In September 2017, Morison entered into a fixed-price contract with Amazon Sdn. Bhd. The contract will expire in September 2019. Due to increase in the cost of the materials purchased by Morison for the contract, the directors of Morison estimate that the contract will make a total loss of RM0.2 million. The directors of Morison have refused to provide for this loss in the financial statements as they maintain that the loss on this contract will be offset by profits on other contracts in the year ending 31 December 2018.

The draft financial statements show that Morison's profit before tax is RM10.2 million and total assets are RM75 million.

Asda Sdn. Bhd. (Asda)

Your firm's evaluation on the directors' assessment of Asda's ability to continue as a going concern included an examination of the company's financial forecasts prepared by its directors for year ending 31 December 2019. Your firm has concluded that there are significant doubts as to whether Asda can continue as a going concern. The directors of Asda prepared the financial statements on the going concern basis. The notes to the financial statements include adequate disclosures in respect of the uncertainty related to the going concern assumption.

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Sainsbury Sdn. Bhd. (Sainsbury)

Your firm has completed an engagement to review and provide an assurance report on Sainsbury's consolidated financial statements. This assurance engagement was requested by Sainsbury's directors to support the acquisition of funding to grow the business. Sainsbury has recently acquired a subsidiary Waitrose Sdn. Bhd. (Waitrose). Sainsbury has not consolidated the financial statements of Waitrose but has included it as an investment, at cost, in the consolidated financial statements. This accounting treatment is not in compliance with International Financial Reporting Standards. Had Waitrose been consolidated, many elements in the financial statements would have been materially affected.

Required:

- (a) For each of the situations described above, explain the implications, if any, in the auditor's report. (11 marks)

- (b) State in brief, the difference between the scope of an external audit of a public sector organisation and the scope of an external audit of a limited company. (2 marks)

- (c) An effective internal audit function may reduce, modify or alter the timing of external audit procedures, but it can never eliminate them entirely. Describe the factors that the external auditor need to consider in order to be able to place necessary reliance? (2 marks)

(Total: 15 marks)

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QUESTION 4

Your firm is the external auditor of West Drayton Beauty Sdn. Bhd. (WDB) which is a beauty therapist and manufacture cosmetic products in Malaysia. The following matters arose when performing the audit planned procedures for the year ending 31 January 2018:

- i. When reviewing the accounting records for significant journal entries, it was noted that the year-end journal to record prepayments had been posted to the general ledger twice in error. The journal entries had not been authorised or reviewed and IT controls do not prevent the posting of journals with a reference number which is identical to an existing journal.
- ii. Your firm's analytical procedures identified that trade receivables days had increased from 36, at 31 January 2017, to 47 at 31 January 2018. WDB's credit terms are 30 days. Enquiries of management revealed that trade receivables included an overdue balance of RM180,000 in respect of Skin Care Therapy Sdn. Bhd. (SCT). SCT has refused to pay the balance because they claim they did not receive the goods. WDB does not retain evidence that goods have been dispatched from its warehouse or received by its customers. The directors do not consider it necessary to make any adjustments to the financial statements in respect of this matter.
- iii. During your review of WDB's internal audit report, you noticed that some cosmetic products was incorrectly classified resulting in low quality product being sold as high quality product. The directors of WDB have informed the industry regulators and have taken action to rectify the matter.
- iv. You were also told by the staff of WDB that the company frequently replace Alya, the trained-practitioner of a laser treatment machine with any available staff when she is on leave. The industry requires all beautician to have their respective license especially when it involves machineries.

Continued...

Required:

- (a) State the internal control deficiencies identified when performing the planned audit procedures mentioned in situation (i) and (ii). For each deficiency, outline the possible consequence(s) of the deficiency and provide recommendation(s) to remedy each deficiency.
(6 marks)
- (b) Identify the business risks to which WDB is exposed as a result of situation (iii) and (iv). For each risk, state the implications for the financial statements.
(5 marks)
- (c) Explain the benefits and limitations of using analytical procedures at the planning stage of an external audit.
(4 marks)

(Total: 15 marks)**Continued...**

QUESTION 5

According to ISA401 Auditing in a Computer Information System (CIS) Environment, the CIS environment will exist when companies use any computer device to process the financial information. The use of information technology (IT) and CIS by the entity can enhance the efficiency and effectiveness of an entity's internal control and may also pose specific risks to an entity's internal control.

Required:

- (a) Explain the risks and measures to overcome these risks in an online sales ordering system. (10 marks)

Melati & Co is an audit firm operating in Shah Alam. For the past few years, the company has utilised Computer-Assisted Audit Techniques (CAATs) to facilitate them in searching for irregularities from a given data. CAATs help the auditor to provide more analytical result and make use of computer applications to automate and facilitate the audit process. The use of CAATs ensure that appropriate coverage is in place for an application control review.

Required:

- (b) Explain two (2) common types of CAATs. (2 marks)
- (c) Explain the major steps to be undertaken by the auditors in the application of CAATs. (3 marks)

Anggerik & Co, an auditing firm, uses a random samples in performing audit tests whenever possible. They believe that this gives them the best chance of getting representative samples of their clients' accounting information. The objective of using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

Required:

- (d) Explain the reasons for using sampling in audit. (2 marks)
- (e) Briefly explain the instances when sampling will not be appropriate. (3 marks)

(Total: 20 marks)

End of Paper